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General Business Conditions

THE slump in business has become more pronounced during November, with staple commodity and security prices declining to new lows and further curtailment in the industries. Whatever business men may think as to the duration of the recession, it is plain that they are taking no more risks than they have to, but are following policies of the utmost prudence. The tendency in all lines is to hold buying down to nearby requirements, reduce commitments and work off inventories, and cut production where necessary to prevent stocks of goods from piling up.

The situation illustrates the spontaneous nature of the fluctuations of business between good times and bad. The business of the country is an aggregate of the actions and policies of millions of individuals and corporations, all following the best judgment they can bring to bear on their own problems; and it might be supposed that their differences of opinion would cancel out. But that is not always the case. They are all subject to the same economic and psychological influences. By and large they tend to go forward together, planning and spending confidently; and conversely, they curtail and economize together. The changes from one policy to the other mean a vast difference in the volume of trade and the level of prices.

Factors in the Recession

In the early part of this year confidence was running high, the price structure was firm, and forward buying was the rule, but the present situation is exactly the reverse. The enthusiasm that prevailed was its own undoing, since it led to accumulation of inventories, over-speculation, and over-stimulation of production. Wages were raised and hours shortened. The resulting increases in costs were accepted because the demand for goods seemed strong enough to support them, even where increased prices were necessary. However, there was a good deal of misjudgment and miscalculation of the situation. The rise in raw material prices was overdone, since the buying was swollen by anticipation of future needs and over-optimism, and the supply of commodities was quickly increased by expanding production. A severe price decline has followed, and it has become the chief influence upon business policies.

For a time price declines feed upon themselves. Of course the natural policy in a falling market is to keep clear of commitments which might prove to be out of line with what competitors could do by waiting. Buyers of raw materials have shortened up their coverage, and the drop in sales makes stocks on hand last longer than was expected when they were bought. Moreover, the decline in raw materials makes finished goods prices look unstable, regardless of the fact that manufacturing costs are high. This reduces buying by distributors. In turn, producers are reluctant to build up inventories by manufacturing for stock. They do what they can to keep their organizations intact, provide employment, and maintain the purchasing power of their workers; but as a general rule they cannot afford to operate long in excess of orders received. In a falling market especially, accumulation of unsold goods could be ruinous.

It is unfortunate to have production reduced, for there is always need for more goods, and at present for more employment. But it is manifestly incorrect to blame any individual for the situation. No manufacturer can wholly control even his own business, for the market for his goods lies principally among other groups, and his production must conform to his sales. In the complex system of exchange of goods and services which make up business, employment is provided not by arbitrary decisions of factory owners, but by the system itself. When in order it furnishes work for all and when it is in disorder and trade is checked a temporary slowing down is unavoidable.

All business recessions proceed more or less in the manner outlined. They grow out of maladjustments and they have to go on until readjustments are made. Of course recessions differ in that the causes of the disturbance, and the character of the adjustments required, vary

with the circumstances. But all are alike in that the effects are progressive, searching out any weaknesses that exist in the economic structure. Moreover, the decline itself, starting out of a loss of balance in economic relationships, further disturbs the balance, due to the unequal fall in prices and the difficulty in getting costs down as prices drop. If all prices came down together trade could go ahead on the same relative terms, but this is never the case. The inability to reduce costs commensurately with the drop in prices and volume cuts into the profit margin; and this has a depressing effect in many quarters, including the security markets and the capital goods industries, which prosper only when business generally is making money.

Production Curtailment Drastic

The fall of prices and production during the past three months has been exceptionally rapid, which may be due to the importance of political factors in the economic situation, and the greater uncertainties resulting; or to the lessons that business men learned from carrying on over-optimistically in 1929 and 1930. Almost all the staple commodity markets and most of the industries conform to the recession. Moody's index of 15 commodities which are dealt in on organized exchanges has dropped 30 per cent since the middle of August. The Federal Reserve Board's index of industrial production was 117 in August (1923-25 = 100), 111 in September, 103 in October, and according to preliminary figures will be in the low 90s for November. This indicates a cut in output of around 20 per cent in three months.

For purpose of comparison the last quarter of 1929 provides an equivalent period of unpleasant memory, which included sharp drops in the stock market and the general indexes; but the decline in production during the three months in 1929 was only 15 per cent, though it started from a higher level. Staple commodity prices dropped 11 per cent, according to the Moody index. Compared with the 1937 decline this seems almost insignificant, but the principal drop then did not come until 1930.

These figures show the rapidity with which business men have moved to reduce their commitments and get inventories down. The steel industry has experienced such a drastic slump in orders that mill operations have been cut by over 60 per cent since the first of September, from 84 to 30 per cent of capacity. This is the worst drop ever experienced in a like time. Undoubtedly it carries steel production below the ultimate consumption, representing a shortening up of stocks all along the line. In 1929 steel operations were at 86 per cent on the first of September, declined to 67 by the end of November, and dropped only to 59 (leaving out Christmas week) before turning up in January, 1930.

The Non-Ferrous Metals

The decline in business in non-ferrous metals has likewise been sharp. Domestic sales of copper during November have averaged 750 tons daily, which compares with 900 in October, 1,150 in September, and 4,900 the average of the last quarter of 1936. The electrical manufacturing industries have not reduced their consumption of copper greatly, being of the fortunate group which still have good unfilled orders, but the brass companies and other fabricators have curtailed, and the buying policies of all are in line with the general conservatism. Meanwhile the copper producers have also begun to curtail, but mine operations are less flexible than those of factories, and with deliveries falling the statistics show stocks backing up in producers' and refiners' hands, to the extent of an 80,000 ton increase since April 30. It is safe to say, however, that producers will not accumulate stocks very heavily, and the price has been dropped by stages to 10¾-11, from 14 in late September. This is low enough to discourage production in some of the high cost mines, and is the natural way to deal with the situation, instead of relying upon price pegging.

In lead and zinc also the slump in buying has been drastic, shipments have declined, and consumers plainly are reducing stocks. Producers' stocks are on the rise, as in copper, but there was room for an increase in reserves, especially in zinc, imports of which have been heavy. Meanwhile curtailment in the mining districts is spreading. Price cuts, influenced both by the London market and by the change in the domestic situation, have carried lead down to 5 cents and zinc to 5¼.

The paper industry is another in which the demand has dropped off sharply and curtailment has become severe.

Better reports come from some of the heavy industries, including electrical manufacturing, as noted, machine tools and industrial and farm machinery, and aircraft. This may be a surprise to some, in view of the impression that these industries suffer more severely in recessions than those closer to the consumer. The fact is that commitments made in them naturally have longer to run, and they received large orders earlier in the year, which will keep them busy. Moreover, in some cases at least new orders have continued to exceed or compare favorably with a year ago, reflecting the unsatisfied need for these products.

Building figures continue to disappoint as compared with earlier expectations, but have remained in line with preceding months. For the first three weeks of November the daily average of contracts awarded, according to the Dodge figures, was 4.9 per cent above October,

and 0.7 below a year ago. For residential building only the corresponding changes were 5.3 above, and 10.1 below, respectively.

Consumer Goods Trade Slower

Most of the industries selling to the consumer, directly or through mercantile channels, are experiencing a disappointing Fall. Both merchants and manufacturers went into the season with heavier inventories, and the effort on all sides has been to reduce them. This has left the wholesale markets dull and soft, compelled manufacturers to curtail, and depressed prices of the raw materials they use. Shoe production is sharply below a year ago and last Spring, and prices of hides, after a long deadlock between packers and tanners, have broken 8 cents from the August top, which was 17½ cents on spot light native cows. The Spring woolen season, which at this time last year had two or three active months behind it, refuses to get going, due to a disappointing movement of men's clothing at retail for some time past and general caution in the clothing trade. Wool manufacturers have cut prices on their Spring lines without avail, and the price of raw wool has slumped both here and abroad, the Boston market being off around 30 cents on the top grades.

Cotton goods sales have continued below production despite mill curtailment of 25 per cent, comparing October with the peak last March. Undoubtedly the forward buying of cotton goods early in the year was overdone. Stocks have accumulated in distributors' hands which are now being worked off, and in Worth Street the seasonal buying has failed to appear. Curtailment is necessary to keep stocks from backing up in mill hands, and may become more severe, in view of the decline in unfilled orders. The rayon yarn industry, growth of which was interrupted in only one year of the depression, and which has been hard pressed to meet the call for yarn during the past two years, is finally curtailing, due to accumulation of stocks of broad goods and a sharp drop in weaving operations.

The automobile industry has no finished goods inventory problem to deal with, since it is able to measure its sales to consumers at weekly or ten-day intervals, and adjust accordingly, but it is not immune from disappointments. Sales expectations have been revised downward since the opening of the season, and some producers including Chrysler have begun to curtail in order to avoid overstocking dealers during the Winter. The Ford company, up to the last week of the month, was still not in full production on its new models. The result is that assemblies during November and December will run behind last year by a greater margin than heretofore expected. Retail sales reports through the early part of November were among the more favorable business items, but the new models were introduced considerably earlier this year than last, and the gains were for periods which are hardly comparable. Parts manufacturers are curtailing, and tire output, with manufacturers carrying good-sized inventories, is running considerably behind a year ago.

Inventory Reduction Under Way

These are the facts of the industrial situation, and they make as nearly a uniform showing as they are ever likely to. Undoubtedly there are two interpretations that may be put upon them. To the extent that stocks of goods between producer and consumer were excessive, and needed to be reduced, the curtailment is constructive, for it is clear that the correction is being applied more sharply than ever before. Although retail reports have admittedly turned less favorable, there has been no such slump in trade as in production. Taking October as the last month for which all figures are available, department store sales were off 1 per cent, and but for one less selling day in the month would have been up slightly. Chain store sales were up about 3½ per cent, the large mail order houses 5½ on the average. All these figures are in dollars, and since prices are higher the volume of goods distributed was probably less than a year ago, but not by any great margin. By contrast, cotton consumption, on a daily average basis, was off 14 per cent, wool consumption 43 per cent, and shoe production 25 per cent. Production of rayon broad goods was sharply lower, having been curtailed around 40 per cent from the peak. In November trade comparisons were poorer, but production was off further also.

These are rough figures, but they support the common observation that inventory reduction is sharply under way, and manifestly this is one of the requirements to get business in shape to go ahead again. Moreover, the liquidation is running in orderly fashion, and most stores will have their stocks down to conservative figures by the end of the Christmas trade, or at least after the January sales. In some lines stocks will back up in producers' hands, but the producer is awake to this. If curtailment has to come, it is in the general interest to get ahead with it, in order to get it over more quickly.

On the other hand, it is not sound common sense to welcome, for any reason, a decline in production which puts people out of work or reduces their purchasing power, for how long will trade hold up if unemployment or shortened hours spread widely in the factory centers? The problem is not as simple as one of balancing inventories with respect to a fixed level of trade, for there is no fixed level; the real problem is to escape the vicious circle in

which trade and production follow each other downward.

Comparison With Past Recessions

There remains the question: How far will the reaction go? Is this a temporary slump or the beginning of a major reaction? No positive answer can be given, for it depends on future conditions.

We gave in this Letter last month reasons which support the argument that the recession is of the type which should be temporary rather than the beginning of a major depression; and will repeat them briefly. Preceding the recession there was no such general inflation of credit, of construction or capital investment, as has preceded past depressions. There was no such inflation of prices and enormous inventories as in 1920, and no such body of private debt, or of international debt, as in 1929. Government debts are far larger, but Government debts will not be liquidated. There is a plethora rather than a scarcity of credit and money rates are unprecedentedly low. Real estate values are drastically deflated. The assets of the banks and other credit institutions are incomparably less subject to deterioration through business depression than in 1929; deposit insurance reserves are available to protect bank depositors, and it is hardly conceivable that anxiety as to the banking system can recur.

These points are generally conceded, and their effect undoubtedly is to limit the possible volume of liquidation and deflation, to a far smaller amount than existed in either 1920 or 1929. With respect to the volume of foreign capital in this country, possibly subject to withdrawal, the situation is more like 1929, but as subsequently pointed out in this Letter the country is in a vastly better position to repay these funds without shock to the credit structure.

The Chief Adjustments Needed

In view of the foregoing, it is natural to ask why, in a short time, the recession has gone further than other temporary interruptions in an uptrend, for example the 1923-24 decline. In that recession the total decline in production was only 21 per cent, in stock prices only 16 per cent and commodity prices were hardly disturbed. And will the answer to this question expose the dangers to be guarded against?

In answer there are two points to be made. In the first place, it is plain that there are greater impediments to the formation of capital, and its free flow into productive use, than existed in 1923-24, or ever before. A greater proportion of the national income than ever before, from 16 to 20 per cent in recent years, is routed into Government treasuries, and by and large the income thus diverted is not put to reproductive use, in which it will create more capital. Furthermore, the tax system by which the income is collected operates in some ways to discourage both saving and enterprise. The capital gains tax and high surtaxes penalize risk-bearing, and the undistributed surplus tax penalizes savings by corporations.

It is heartening to know that revision of the tax system in some respects is promised, and that there will be some relief from the burden upon enterprise. One of the first needs in the current situation is to encourage the formation of capital, by Government economy and tax revision; and to encourage investment by giving enterprise more scope, free of unnecessary obstruction, dictation as to the terms upon which it must operate, and subsidized Government competition.

The second danger in the situation is allied to the last point. It is the danger that comes from the constant and arbitrary increase in the rigid elements in the economic system; in the fixed costs, the inflexible wage agreements running over considerable periods, the arbitrary rather than natural introduction of shorter hours and practices raising labor costs, the crop control schemes and price-supporting programs. All of these tend to impair the self-balancing ability of the economic system. When costs and prices get out of line pressure is automatically put upon the points where correction is needed. But if there is no "give" or flexibility, no general cooperation in keeping the balance or understanding of its importance, price and cost relationships are thrown into disorder, and the trade disruption becomes worse and unemployment greater.

Importance of Price Disparities

It is inevitable that sooner or later disparities in prices will present themselves as the chief obstacle to trade improvement, and if the question could be faced as early and vigorously as the inventory situation has been faced, the prospect for an early turn for the better would be immeasurably enhanced. Raw material prices in general are now lower than they have been since the first year or so of the recovery; some manufactured goods have been reduced, notably in the textile and apparel group, but others are unchanged at the 1937 peak, some even still advancing. Business will not readily improve while disparities among prices are increasing. The producers of the commodities which have declined sharply are losing purchasing power in terms of the goods which have not been marked down, and the producers of the latter are losing markets and employment.

It is fortunately true that farm income has not suffered as much as farm prices, and the farm situation is a support to business. Farmers have sold their wheat at good prices, they are making good profits in feeding cheap corn to relatively high priced livestock, and the cotton income is helped out by Government payments and support of the market. Never-

theless, the gains in farm income are not as great as were expected earlier, and the outlook is not too favorable, since next year's crops will have to compete with larger supplies left over from this year. The Bureau of Agricultural Economics has made an official prophecy to the effect that farm income in 1938 will be lower. If that is the case the industries will have to make lower prices to the farmers to sell to them.

Price disparities can be attacked from both sides and preferably should be. The situation will be dangerous if producers of raw materials have to take further cuts, for the difficulty of keeping finished goods prices in line will be correspondingly increased. On the other hand, efforts at price pegging involving artificial curtailment of production to uphold the price can only cause unemployment and contribute to the general recession. Unquestionably the sound and lasting way to improve commodity prices is to increase the demand for them, and the most promising approach is the encouragment of business to go ahead with plans for new projects, expansion and improvement.

Business Conditions Abroad

Although the people of the United States just now are preoccupied with their own industrial slump, a brief summary of business conditions in other countries may be of interest. The fact that a general recovery has occurred should correct any impression that we have been having it all to ourselves, and also suggests that present tendencies may be either restricted or protracted by the trend elsewhere. According to computations of the economic bureau of the League of Nations, the physical volume of world trade in the first six months of 1937 equalled 95.6 per cent of the 1929 average, although measured in gold the monetary value was much lower.

Signs of recession from the peak of industrial activity and prices of last Spring are reported in other countries, but in none are they so pronounced as in the United States. This may very well be because the rise of the last year was more acute in the United States, being abnormally accentuated by the price-rise of agricultural products, due to last year's drought, and the influence of the disbursement of the adjusted compensation to war veterans. These combined influences caused a congestion of demands on the industries in the second half of 1936, with the result that industrial costs and prices were forced to an abnormally high level, from which some reaction was inevitable.

One reason given for the payments to veterans was that it would give a "start to business," and so it did, but a stimulus that imparts temporary driving-power has after-effects to be reckoned with. The drought caused a short crop to sell at a higher average value than any normal crop had brought in many years, but it did not increase the wealth of the country, nor were the benefits distributed equally even among farmers.

Such abnormal conditions do not establish prosperity on a firm basis, but rather tend to alter relations within the economic system in ways that make trouble later on. The years of comparative idleness in the industries, with an increasing deficit in normal development, had not prepared the system for the sudden demands upon it. In no other country did the situation change so suddenly, or have such violent effects upon wages and prices. The most important condition for the maintenance of prosperity is approximately stable relations between supply and demand.

Recovery in Europe

Industry had been recovering in England over several years. House-building was the principal activity, but foreign trade was reviving. While the peak of the home-building demand evidently has been passed, business in general has been sustained by the rearmament program which assumed large proportions last Winter and promises to be an important factor for several years to come. Heavy industries are reported active, with September and October iron and steel output at post-war records, and order books well supplied ahead. On the other hand, signs of lessened pressure have not been altogether lacking in other directions, textiles especially feeling a definite slackening of new business. How far the fall of raw commodity prices, with attendant repercussions in many countries, will affect British prosperity is too soon to say, but it cannot be doubted that the price reaction, together with the business recession in the United States, have greatly influenced sentiment in Great Britain and elsewhere, and prompted private buyers to be more cautious. As indicated in a later paragraph, prices on the London stock market have been declining for some months.

Germany and the Scandinavian countries have been on a rising trend of activity for several years. Although Germany is laboring under the handicap of a poor crop, necessitating an increase of food imports, and of a scarcity of raw materials of home production, she lifted her exports in October to 543,000,000 marks, 112,000,000 marks more than in October, 1936, and showed an export surplus over imports of 370,000,000 marks, in the first ten months of this year. This is the more remarkable in view of reports that her substitute raw materials are costly. It is noteworthy that the "trade compensation" idea of special bargains is no longer popular even in Germany. Unemployment is the lowest in recent years.

Sweden is a country of highly efficient industries, and in the last four years has enjoyed an

exceptional business expansion. Unemployment is negligible; in fact, workers have been imported from neighboring countries. Recently, the Stockholm correspondent of the London Economist reported the iron and steel industry to be running at capacity with "orders booked ahead for at least another eight months." Notwithstanding this favorable situation, the same authority, in a subsequent dispatch, notes some hesitation in certain lines. Owing to unabsorbed stocks of timber in Great Britain and Holland, "Swedish sawmill owners show great caution in completing their raw material requirements." It is stated that about 85 per cent of the 1938 production of chemical as well as of mechanical pulp has been placed, but that lately further contracting for 1938 and 1939 has been slowed up.

The revival of world trade has brought practically all of the idle shipping into use, and brought about a rise in freight and passenger rates. Norway has been lifted into prosperity, with a balanced budget and a substantial reduction of the public debt. The banking situation is healthy. At a meeting of the Norwegian Bankers' Association in September, the President said that he did not foresee any imminent fall in world prices, but called attention to the fact that a continued rise of the cost of production, building, etc., would inevitably lead to a recession sooner or later. The pulp, paper and agricultural interests of the northern countries, including Finland, have had a very prosperous year. As indicated above, recent events have raised some doubts as to the outlook for pulp and timber.

Holland has shared in the shipping recovery, and her foreign and colonial trade has been large, but the Premier sounds a note of caution about the rising costs of government, and particularly the "relief" expenditures, which remain high and have burdened the country with debt. Since gold has ceased to come to the United States, the reserves of the Netherlands Bank have become almost unmanageably large. The increasing production of gold increases the problem of what to do with it.

Belgium has had capacity production for the steel industry, and to the end of September that industry had shown no signs of slackening, although some business has been lost by the war in the East. At the middle of November the industrial demand for coal was reported as exceeding the output, and stocks were low. On the other hand, the textile industry was reported as unfavorably affected by the decline of raw cotton, which has checked the buying of goods, as elsewhere. The glass industry also was receding, possibly a seasonal sign. Bank deposits and railroad earnings have been well above last year. The close relation of the Belgian currency to the French has been an element of uncertainty.

Situation in France

France, as for several years, presents perplexing conditions. The Chautemps Government, with Bonnet as Finance Minister, has had a good degree of success with a difficult situation. The preceding ministry had devalued the French currency in 1936, for the second time, in the hopes of stimulating industry and overcoming the adverse trade balance, but its social policies, in behalf of higher wages and the 40-hour week, have raised both industrial and living costs, practically defeating these purposes. Construction has been depressed and the industries restricted by the high costs. Both civil and private employes are pressing for higher wages to offset higher living costs, most of which is suggestive of recent developments in the United States.

The budgetary situation has been improved by new tax levies, and the position of the currency has been improved. The most favorable recent development has been a movement of about $25,000,000 of gold to France from the United States, which no doubt is a repatriation of French capital, and is assumed to result from the changed outlook for business in this country. The effect is to ease the money situation in Paris, and the Treasury has announced that it will pay off a loan of £40,000,000 in London. The repatriation of capital is all good, but an adverse trade balance of increasing size is disquieting. The conflict in Spain intensifies dissensions in France, and the industries suffer from them. The most hopeful of recent signs has been a more conciliatory attitude on the part of labor leaders.

Latin America

The marked characteristic of the recovery everywhere has been the increased purchasing power of the primary industries since 1932-33. Agriculture, livestock raising, mining, lumbering, shipping, etc., have regained normal relations to the other industries, with beneficial results all around. The countries of Latin America, which from 1930 to 1933 were in the depths of depression, have broadened and enlarged their production, diversified their industries, and the rise of prices, 1936-37, has improved their finances decidedly. In the first six months of this year reports were extremely favorable. Thus in that period the eight leading Latin American countries had an export surplus of $457,000,000 against $244,000,000 last year, and $413,000,000 for the *full* year of 1929. Aside from the larger volume and high prices, these export surpluses were due in part to a lag in the rate of imports. Because of this lag, imports have generally kept high during the latter half of 1937 and afforded good support to the manufacturing industries of Europe and the United States.

In the ten-month period ended last June, Argentina accumulated a favorable trade bal-

ance of over one billion pesos ($300,000,000). Since June the export surpluses have practically disappeared, because of the rise in imports, which have come almost to the 1929 average. Argentina's capital goods imports have risen almost 50 per cent over last year. Chilean exports practically doubled in the first eight months of this year, and the export surplus is approaching $90,000,000, against last year's figure of $29,000,000. Brazilian imports in the first eight months of 1937 expanded from about $157,000,000 the year before to $210,000,000, Germany leading the United States as the chief source. More recently Brazil has been hit by price-declines in coffee, cotton and cocoa, and Uruguay has suffered by the decline of wool.

The recovery of Peru has been consistent since 1933, due to improved production and prices for cotton, now its principal export, and for its other exports — copper, petroleum and sugar. The ordinary revenues have increased from 86,517,000 soles in 1932 to an estimated 153,600,000 soles for 1937. In the last two years a budget surplus has been realized and used for public works. The chief cloud at present is the declining price of cotton.

Even before the war some of the Latin American countries had made a start in manufactures, and the rise in prices of imported goods encouraged this movement. The production of oil, minerals and new crops has increased. Argentina and Brazil are especially active in manufactures. However, other news from Brazil is of a disturbing nature, relating to both coffee and cotton. After giving government support to coffee prices for thirty years, and watching the world crop increase from year to year under this stimulus, the Brazilian Government now has altered its policy to one of defense and competition. In this connection the Government has announced complete suspension of interest-payments on all obligations held abroad, including those of fifteen states and seventeen municipalities. Apparently, the exchange situation, which depends mainly upon coffee, is the factor making trouble, but the decline of cotton may be a factor also. The action on coffee is important and will give the advocates of crop-control something to think about. The cotton news is that the Brazilian crop is increasing rapidly, and that from Mexico to Peru and Argentina, and around the Caribbean, all countries have been getting into cotton and cotton goods, and that this is another result of crop and price-control.

The action of Brazil on coffee seriously affects Colombia and the Central American countries, where coffee production has been increasing. The price in Colombia is off about 3 cents per lb., which would mean about $12,500,000 to $15,000,000 on Colombian exports in one year. The Colombian Government indicates that it will restrict imports if necessary to protect the balance of payments, i. e., to compensate for the loss of purchasing power.

Central and Southeastern Europe

Central and Southeastern Europe have taken on new life and hopes. Austria and Hungary, which have been divided and sub-divided until little seemed to be left, are in greatly improved positions, and the entire Danube basin is comparatively prosperous, chiefly as a result of the gains to agriculture. Austria has been discharged from the financial supervision of the League of Nations, as able to go alone. Payments of interest or capital on foreign debts no longer are restricted, and other exchange restrictions have been greatly reduced. Enlarged tourist business has been an important factor in Austrian recovery.

Italy has continued to increase agricultural production, and is said to require no wheat imports this year. Foreign trade figures, exclusive of colonial trade, for the first nine months of 1937 show an adverse balance of about 4,400,000,000 lire, against 1,970,000,000 lire in the same months last year. It is indicated that tourist expenditures will cover about 3,000,000,000 lire of this year's deficit. On October 19 an extraordinary tax levy of 10 per cent was announced on all corporations operating in the Kingdom, excepting banks, payable in instalments, beginning in March, 1938.

British Nations and Asia

Sections of Canada have had a poor crop-year, but as prices have been higher the aggregate value is reported above last year. Mining production has had a large increase in recent years, and $35 per ounce has had an especially stimulating effect upon gold production. In September the mining activity index stood at 204 (1926 = 100) against 172 for September, 1936. The newsprint industry was setting new records up to August, but has gone to a five-day week to adjust production to consumption. Thus far the chief recession in industry has been in industries producing for the United States market. The index of physical volume of business was down to 123.8 (1926 = 100) in September, from the July peak of 126.5. For the first ten months an export balance of $265,000,000 has been accumulated and this, together with exported gold, valued at $110,000,000, and a favorable tourist season, should again give a large favorable balance on the international account.

The result of the October 23rd election in Australia in which Premier Lyons' administration was endorsed, is attributed to general satisfaction with the recovery from the depression. More than a half-million workers have been added to the industrial payrolls since 1931-32,

and unemployment among trade unionists which then reached 30 per cent, was in October down to 9½ per cent, and for all workers much less. The export price index of Australian products almost doubled between 1932 and April of this year. The cloud on the sky just now is the declining price of wool, and one ominous feature of that is the reduction of imports by Japan, which is substituting twisted rayon "staple", after the practice of Germany.

Gold-mining is the chief industry in the Union of South Africa, and is still expanding, although mainly on low-grade deposits which are being worked at first, while the profits are good, but this holds down the gold output. Agriculture is doing well, excepting wool. The Rhodesian copper mines have had their greatest year.

The situation in eastern Asia is dominated by the war in China which has practically paralyzed that country's trade abroad. In the Bombay region of India there is concern over the decline of cotton, but the textile industries are expanding there and in the Netherlands India, which is not good news for the textile industries of western countries. The rubber industry has recovered.

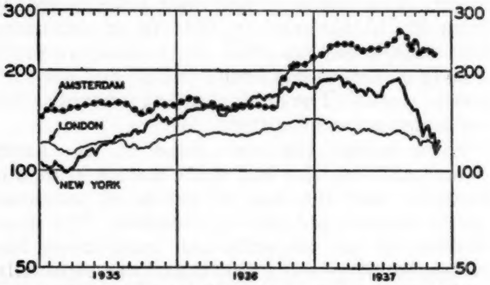
Summary

To sum up this world review, a very substantial recovery from the inevitable post-war depression was made from the middle of 1936 to the middle of 1937, excepting countries at war, but since then new difficulties have appeared because trading relations have become disordered. The symptoms are more evident in the United States than elsewhere, because the costs of production were forced up more abruptly here, causing a falling off of consumption and employment. Furthermore, the conditions here are reacting upon other countries, affecting confidence and enterprise. Once started, the effects of such slow-downs tend to become cumulative in force and scope.

The situation affords an oft-repeated demonstration that the best prosperity for every country requires that all countries shall share in it. If any lose their share the others do not find it, but lose a part of their own. The full purchasing power of all is required for record prosperity, and this is to be had only by well-balanced production and trade. This has been hard to maintain since the Great War upset the equilibrium. The United States illustrates this better than any other country, for its tremendous swings, to first one extreme and then the other, disturb all trade.

The Stock Market Declines

That the stock market should forecast general business conditions does not make sense to most people, but the prices of shares are closely related to the volume of trade. Profits are a margin between costs and selling prices, and a rise of costs, easing of prices or lessening of volume, all directly affect profits, and often occur together. Owners of shares are keenly aware of the inflexibility of costs, and know that peak operations are seldom continued long. The three stock markets having the widest range of securities and the widest clientele of traders are those of New York, London and Amsterdam. Herewith is given a chart of three lines which shows the trend of prices on the three exchanges from the beginning of 1935 to the present. The sudden jump of Amsterdam in 1936 reflects the departure of the guilder from the former gold standard, which started Dutch prices on an upward course. The light thin line that represents London follows a more uniform course. The sudden decline of the New York line within about two months is much more precipitate and reflects a higher range of costs, a sharper loss of profits and a keener sense of alarm.



Indexes of Industrial Stock Prices in New York, London and Amsterdam.

That this reflection of stock prices does not truly reflect the trend of all business of course is true, but that it reflects the trend of very important business is proven by the drop of steel production from 84 per cent of capacity the first of September to 30 per cent by the end of November, and in view of the weight of the United States in world markets, it is not strange that such signs should give a check to business in all parts. That decline has been taken as a signal to "stop, watch and listen." Moreover, similar signs are reported elsewhere; business has slowed down and prices are declining, in foreign markets as well as at home.

Cooperation vs. Unemployment

Comments upon the question, "How far will the reaction go?" are given in the discussion of General Business Conditions earlier in this number, and need not be repeated here.

One feature may be emphasized, although often reverted to in these columns. This is the lamentable absence of knowledge of the "economic equilibrium", which is the very basis of prosperity. The economic system is a highly specialized system of interdependent parts, and the parts can no more operate without each other than can the parts of an automobile or

a watch. They must work together like the parts of a machine, and the game of "grab" which attempts to raise the compensation of single groups at the expense of all the others, always meets with disaster. If in any degree effectual, the offending group will lose more by unemployment in its own ranks than it can gain by the nominal increases. This applies alike to nations and smaller groups.

We cannot pursue this subject further here, but give the following extract from a recent book by a well-known British economist, Sir George Paish*. The book is a very sincere and earnest effort to impress upon readers the folly and danger of such policies as brought on the Great War, and have kept the world in continuous turmoil and strife since. The book is very well summarized in this extract from the Introduction:

Let me state at once that I should not place this grave situation before you, did I not realize that it can be changed if everyone can be caused to realize its gravity and so be prepared to act with understanding and common sense. The present danger has arisen in the main because everyone is working in a separate compartment and does not understand or appreciate the relationship of his own activities to nations as well as to individuals. Each person imagines that he has merely to consider his own narrow interest and all will be well; and does not realize that unless his interest is in line with the common interest, sooner or later disaster is inevitable. How many of us recognize the truth of that very wise statement made collectively by the world's greatest men of business before the breakdown in 1929, in their effort to prevent that breakdown? They said, 'Your neighbors are your customers and their welfare is essential to your own well being.' What a different world it would be today if as individuals we realized that the prosperity of our neighbors was essential to our own prosperity, and that to enjoy great prosperity, each one needs not only to cause no injury to his neighbors, but to do all that lies within his power to promote the general welfare. What an amazingly prosperous world there would be if we all helped each other to be prosperous, realizing that our own prosperity would follow as inevitably as day follows night, if we sought our own welfare instead of seeking our own self-interest at the expense of others.

The book sets forth the principles that long have been recognized by master authorities as the basis of economic, as well as moral, law.

Money and Banking

The money market was easier in November, average rates on weekly offerings of Treasury bills maturing next March dropping to 0.117 per cent, compared with 0.261 per cent on October 27 when the Treasury shifted its bill financing from 9-months bills to bills maturing at the March quarterly tax period. At the close of November, the average quoted return on all outstanding Treasury bills was approximately 1/10 of 1 per cent, with bills falling due beyond March affording little better returns to investors than the March maturities. Other than on Treasury bills, money rates were unchanged.

*Note: "The Way Out", by Sir George Paish, formerly adviser to the Chancellor of the Exchequer, and representative of the British Treasury in the United States during the War; G. P. Putnam's Sons, New York; price $2.75.

The easier tone of the money market accompanied a further increase of member bank excess reserves to $1,140,000,000, the largest since the final increase of reserve requirements went into effect last Spring. In addition to the "desterilization" of $300,000,000 of "inactive" gold in September, excess reserves have been increased this Fall by a decrease of bank reserve requirements consequent upon a shrinkage of bank deposits, and by additional purchases of Government securities by the Federal Reserve Banks. In the three weeks ended November 24, the latter added $10,000,000 of Treasury notes and $27,825,000 of Treasury bills to their previous holdings, carrying their portfolio of all Government issues to a new high level of $2,564,000,000. While the aggregate of these purchases was not large, they contributed materially, in a sensitive market, to the lowering of rates.

A factor also in the money market this Fall has been the failure of currency requirements to show the expected seasonal expansion. Owing no doubt to the recession of business, the volume of currency outstanding averaged no higher in November than in September, whereas usually there is a substantial increase. During recent weeks the circulation figures have continued to show gains over those a year ago, but by a narrowing margin, the "spread" at the end of November amounting to only $125,000,000, compared with $300,000,000 at the first of September and around $700,000,000 at the beginning of the year. Holiday shopping, of course, will bring an increase of currency demands, but the supply of funds is adequate to meet all requirements.

Further Decline of Bank Credit

Combined statements of the weekly reporting member banks throughout the country revealed further substantial reductions of aggregate loans and investments, and of aggregate deposits, during the four weeks ended November 24.

The principal factor in the decline of loans and investments was the additional contraction of brokers' loans, accompanying liquidation in the stock market. During the period under review, loans of this class decreased by $75,000,000, off more than $500,000,000 since the first of September, while commercial loans dropped by $188,000,000 from the seasonal peak reached in October. With New York City banks bearing the brunt of the decline of brokers' loans, these institutions, in their search for earning assets, have turned buyers once more of United States Government securities, increasing their holdings of these issues by $166,000,000 in the five weeks ended the 24th. Outside of New York City, the reporting banks, as a group, have experienced little reduction of loans to date, and have continued to reduce their holdings of Government securities.

Deposits declined by approximately $400,000,000 during the period, largely because of repayment of loans and withdrawals of foreign deposits. Balances due foreign banks continued to decrease, and on November 17 were $217,000,000 lower than at the July peak.

High Grade Bonds Firm

With money tending easier, high grade bonds of most classes acted well, and long-term Treasury issues closed up nearly a point.

An encouraging feature of the month was the absorption accorded important new security issues offered since August, following in most instances an initial period of indigestion. The next table, giving original offering prices, subsequent low and current prices for several of these issues, reflects the extent of improvement in the market.

Major Corporate Offerings Since August 15, 1937

	Original Offering Price	Subsequent Low	Latest
Central New York Power & Light Gen. 3¾s, 1962	99	92½	100
Idaho Power Co. 1st 3¾s, 1967	98⅛	92¾	99
Ohio Edison Co. 1st 4s, 1967	100½	96½	100
Ohio Public Service Co. 1st 4s, 1962	102⅝	92⅛	97⅛
Rochester Gas & Elec. Corp. Gen. 3¾s, 1967	102¾	104	106

In contrast with the action of the high grade bond market, second grade issues continued weak and irregular in sympathy with the stock market.

Gold Movements and Foreign Exchange

A development of importance in world monetary affairs is the reversal of the flow of gold and capital that has been coming to the United States from Europe since early in 1934. Also, there has been evidence of a changed attitude on the part of the public towards gold. Whereas no more than six months ago hoarders of gold were disgorging their holdings in panic, lest the price should be cut, the past month has seen a new movement to exchange currencies for gold. In the London gold market, the price rose to a premium over the United States Treasury price of $35 per ounce.

The shift in the balance of payments as between the United States and Europe, and revival of gold hoarding, are related to the fall of security prices and recession of business in this country. Rumors have again been afloat of a possible further devaluation of the dollar, as a means of counteracting the trade recession. While there never was good reason for crediting these rumors, nevertheless they have contributed to the outward movement of capital. Ordinarily, such movements would be confined between the banking systems of the several countries, but when questions of monetary stability are raised an alarmed public resorts to the hoarding of gold, in which it now reposes more confidence than in currencies.

When, in pre-war times, the stability of the international gold standard was universally accepted, the movements of trade and of investment capital were governed by the requirements of the common standard, to which all currencies were attached, and which provided a closely-related system of values. Goods were sent where they could be sold in competition on the common basis, and the capital flow was regulated in the same manner. But with no common monetary standard, there is now a constant temptation to adjust the currencies to suit emergencies, and for capital to flow as the changing relations of the currencies may offer profits or greater security. In the one case competition was confined to economic services, while, in the other, competition has been in currency manipulation. A natural result of these experiences is a loss of confidence in the policies of governments regarding their currencies, and a resort to gold for security. At the first suggestion of difficulties, whether caused by war, bad banking, mistaken legislation, or other influences, rumors about the currencies become a factor of uncertainty.

The Gold Inflow After Devaluation

The devaluation of the dollar on January 31, 1934, to 59.06 per cent of its former gold content was the signal for the greatest gold rush that the world has ever seen. The movement represented partly a repatriation of American capital originally sent abroad during the period of currency agitation, and partly an influx of foreign capital attracted by the relative security of our position and the hope of profiting by an expected rise of prices. At the devalued rate for the dollar, the world could buy American securities at a bargain, and lost no time in doing so. In the first two months after devaluation, net gold imports into the United States amounted to over $500,000,000, and as the influx of investment and refugee capital continued, it added altogether in less than four years over $5,500,000,000 to the monetary gold of the country.

All this has raised new problems for the banking authorities to meet. Since the banking system could not absorb and employ this metal at the rate of its arrival, the effect was to expand the volume of idle bank reserves and increase the danger of inflation. To meet this recognized danger, the Federal Reserve Board, acting under the Banking Act of 1935, proceeded to double the reserve requirements of all member banks, and the Treasury adopted the device of "sterilizing" additional gold by purchasing it with borrowed money, and setting it apart in a special "inactive fund" where it would not affect the money market.

Nevertheless, the gold and capital inflow continued, and it was pointed out that the

United States could not go on, indefinitely, raising reserve requirements or buying up all gold offered, with borrowed money. As the flow increased, uncertainty was accentuated by concern on the part of the authorities over "hot money," the term applied to foreign funds temporarily in this country. Rumors spread that a cut in the dollar price of gold was impending, and hoarders in a panic began converting gold into dollars. At this time, also, Russia started selling substantial quantities of gold in London, and Japan began shipping directly to this country. In six months the fund of "sterilized" gold was well over $1,000,000,000.

Following are the figures of monthly net gold imports so far this year, compared with the monthly averages during 1934, 1935 and 1936:

Net Gold Imports of the United States

1934, Monthly average	$ 94,500,000
1935, " "	144,900,000
1936, " "	93,100,000
1937, " " (11 mos.)	142,100,000
1937, Jan.	121,300,000
Feb.	120,300,000
Mar.	154,300,000
Apr.	215,800,000
May	155,400,000
June	262,000,000
July	175,400,000
Aug.	104,800,000
Sept.	145,500,000
Oct.	90,500,000
Nov.	18,000,000*

*Nov. 1st through 29th.

The Situation Changes

Gold imports reached their crest in June, and since then have been gradually diminishing. Gold dehoarding declined sharply in July, owing in part to the large sales already effected and in part to a recovery of confidence in the existing gold price, after repeated denials by the British and American authorities that any change was contemplated; and following, also, an increase of the British Exchange Equalization Fund for the purpose of making gold purchases. Meantime, important developments were taking place in the United States affecting international movements of capital. By August it was apparent that this country was no longer attracting funds as before. While gold imports continued to exceed exports, this was due in the main to a continued building up of dollar reserves by foreign central banks, including notably the Bank of Japan. At the same time, there were indications in the exchange markets that a withdrawal of private balances had begun.

Not until the past two months, however, did this movement reach large proportions. The accompanying diagrams at the foot of the page show the movements of exchange rates and of the price of gold in London during this period. Both sterling and guilders tended to strengthen during September and October, with a sharp run-up in November, sterling selling above $5 for the first time since September, 1936. Even the French franc, which weakened sharply during September and early October, was able to make headway against the dollar in the latter part of October and in November. Meantime, the price of gold in London rose gradually during September and October, and rapidly in November, to a new peak above the New York price of $35 per ounce.

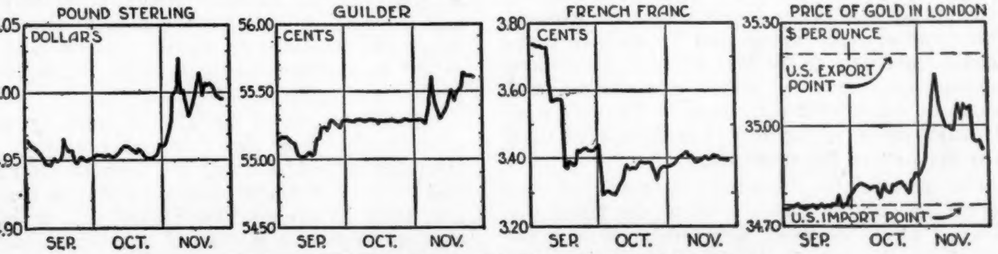
Reported gold losses to European countries thus far have been comparatively small, consisting of $25,000,000 in three shipments to France, and $5,000,000 to Great Britain. Actual losses, however, are believed to have been considerably greater, but to have been met out of the unreported holdings of the Stabilization Fund.

Significance of Gold Outflow

How far the outflow of funds will go, of course cannot be known in advance. In view, however, of the tendencies now in evidence, the following table, based on Treasury reports, of the volume of outstanding short-term accounts owed to foreigners by banks in the United States, as of June 30, last, is of interest:

Foreign Short-Term Balances in the United States

Country	Amount in Million Dollars
United Kingdom	366.1
France	206.2
Netherlands	145.0
Switzerland	329.8
Germany	40.3
Italy	23.0
Other Europe	177.9
Canada	190.1
Latin America	448.8
Far East	210.4
All other	27.4
Grand total	2,165.0



Foreign Exchange Rates and Price of Gold in London
(Gold Price in Dollars, Converted at Daily Closing Exchange Rates.)

A tabulation of foreign funds in this market must include long-term investments, latest detailed figures for which are given by the Department of Commerce as of December 31, 1936. (These figures probably would not be changed materially on June 30, last, inasmuch as the inflow of capital in the first half of this year went largely into bank deposits and short-term investments rather than into the security market).

Foreign Long-Term Investments in the United States

Type of Investment	Amount in Million Dollars
Direct investments (book value)	1,600
Common stocks (market value)	2,700
Preferred stocks (par value)	455
Bonds (par value)	563
Other investments	750
Grand total	6,108

Counting both short and long-term money, it appears that on June 30, last, foreigners had something like $8,200,000,000 of investments in the United States, a large part of which, however, obviously cannot be classed as "hot money." As against possible withdrawals, the United States evidently has ample reserves to spare. Counting the inactive gold fund at $1,250,000,000, the Treasury Stabilization Fund of $1,800,000,000, and member bank reserves impounded by the doubling of reserve requirements at something like $3,000,000,000, the reserve of available cash over and above domestic needs foots up to around $6,000,000,000, without allowing for further possible replenishment of member bank reserves through expansion of Federal Reserve credit via open market operations.

Clearly, the country faces a very different situation from that in 1931 and 1932 when foreign withdrawals of gold reduced bank reserves and forced a contraction of credit. Assuming that the Federal authorities employ the means at their disposal there should be no tightening of credit in the face of even a large outflow of gold. From the standpoint of the Treasury, a moderate outflow of gold doubtless would be welcomed, as putting the Treasury in cash, and cutting down the cost of "sterilization." Were the gold outflow due entirely to improved economic conditions abroad, it would be a salutary development all around; unfortunately, the movement appears to have been induced more by fear of conditions here than by confidence in conditions abroad, and a part of the capital returning to Europe is, as already stated, going into hoards rather than into productive investment.

The unreliable character of much of the verbal speculation which often has been the moving cause of gold movements was illustrated by the rumors last Spring of a cut in gold. If the price of gold actually had been cut, the subsequent business recession and fall of commodity prices surely would have been charged to it, and the case would have been pronounced complete.

Gold Production

Equally superficial is the assumption that because there is a flow of gold to Europe, instead of from Europe to the United States, all problems concerning gold have been solved and disposed of. The fact of chief importance is that the increase of the price of gold from $20.67 per fine ounce at the United States Mint, and approximately similar increases in all monetary systems, have given a tremendous stimulus to the mining of gold. Indeed, it had been increasing rapidly before the monetary value was raised. The world's production of gold in 1900 was valued at $255,000,000 and in 1915 at $476,000,000, a rate of increase in fifteen years far beyond any estimate of the increase of general production and trade. In 1922, on account of the increase of mining costs caused by the War, the output fell to $322,000,000, but by 1933, at $524,000,000, it had surpassed the old record.

From 1900 to 1933 the world output in ounces increased from 12,300,000 fine ounces to 25,400,000, or more than 100 per cent. But in 1934, the weight increased to 27,760,000 fine ounces; and at the new valuation, $35 per ounce, the monetary value was raised from $524,000,000 in the preceding year to $972,000,000, an increase of 86 per cent on the production of that year, not to mention the existing stocks. In 1935 the number of ounces was raised to 31,300,000, in value $1,095,000,000, a rise of almost 13 per cent in that year. In 1936 the total of ounces was 35,500,000 and the value $1,240,000,000, a rise of another 13 per cent. Abandoned gold mines are being reopened, every gold field is increasing its output and every possible field is being explored.

This is the most significant fact bearing on the world monetary situation; but another, and closely related, is the fact that, despite this rising tide of gold, and devaluation of currencies, the world price level, at the close of 1937 is falling, instead of rising. This is conclusive proof that factors other than the money supply are effective upon prices. Evidently the *will to buy* is effective upon prices; also since every group of the economic system buys the products of others with its own, the relations must be in approximate balance.

Obviously, until the rise of mining costs cancels the new profit of gold-mining, the stimulus to gold-mining will remain effective, and whether the new gold goes first to Europe and then to the United States, or the other way around, is a matter of secondary importance. Gold has a way of distributing itself according to the needs and opportunities of the

countries, as evidenced by the fact that little of it remains in the countries where mined.

That the world-wide devaluation of currencies carries the implication of rising prices for the long run, is only confirming what it was intended to do, but it may be doubted that the increased production of gold was foreseen. Neither reserve increases nor sterilization, or both combined, will enable any one country to control its own supply of gold (without complete isolation). Cooperation between governments is essential in dealing with gold to avoid potential inflation of currency and credit. At the moment comparatively little gold is coming to the United States but wherever it goes it will have the potentiality of inflation, whenever there is a sufficient revival of confidence to bring it into use.

The Distribution of Corporate Income

The growing sentiment in Congress toward some modification of the corporate tax laws affords promise of much needed relief to business and comes at a most opportune time. During recent years many new taxes have been imposed upon corporations, while the rates on many old taxes have been raised, so that the aggregate of all taxes paid to Federal, State and local governments has become an increasingly important item in the cost of doing business. Moreover, this burden of taxes is a relatively fixed and inflexible charge, almost entirely beyond the control of management.

Interest in corporate tax revision has centered upon the repeal or modification of the Federal tax on undistributed income, which was introduced last year and which imposes a surtax of 7 to 27 per cent, over and above the normal income tax and all other corporate taxes, upon net income not distributed as dividends. This represents a penalty tax upon earnings applied to the reduction of indebtedness (with certain exceptions) or retained for plant expansion and replacements and for capital reserves.

Tax legislation in recent years has introduced the practice of having varying rates and exemptions for corporations of different size. Further changes in the tax laws that have been proposed, and that are now being discussed widely, make pertinent an analysis of the distribution of income as among the more than 500,000 corporations of all sizes engaged in all the varied lines of business in this country.

Importance of Small and Large Corporations

Small corporations, in point of numbers, make up a very large portion of the total corporations, but they account for only a small portion of the total corporate income produced. A large portion of the corporate business is handled by a relatively small number of large corporations, which have large capital investments supplied by shareholders and bondholders throughout the country and abroad, furnish a large share of the total employment of labor and are large factors in the markets for materials and supplies.

Tables showing the number, net income and taxes paid by all corporations in the United States, distributed according to the size of net income, is given each year in the "Statistics of Income" compiled by the Treasury Department from sworn tax returns. While the total amount of net income is subject to wide fluctuation from year to year, the percentages of net income contributed by the principal size groups runs fairly constant. Following is the average distribution of all active corporations from 1919 through 1933, the latest year for which detailed figures are available:

Reports of All Active Corporations in the United States Distributed According to Net Income Classes, 1919-1933

Income Classes	Number of Returns*	Net Income Reported	Income Tax Paid
No net income	48.8%	— %	— %
Under $5,000	33.9	3.2	0.9
$5,000—100,000	15.3	18.3	16.3
$100,000—1,000,000	1.8	26.5	27.8
$1,000,000—5,000,000	0.2	19.9	21.0
Over $5,000,000	0.04	32.1	34.0
Total	100.0%	100.0%	100.0%

Source: Compiled from Statistics of Income, Treasury Department. Latest detailed figures available are for year 1933. *Excluding inactive corporations.

Taking all active corporations in the United States (numbering approximately 450,000, after excluding 50,000 inactive corporations), the proportion that reported no net income ranged from 34.5 per cent in 1919 up to 81.6 per cent in 1932, and averaged 48.8 per cent during the period 1919-1933. Preliminary figures for 1934 and 1935 show that in those years the active corporations having no net income amounted to 69.1 and 65.1 per cent, respectively, of the total number.

Corporations reporting net incomes up to $5,000 each (which would be less than $100 per week) made up almost 34 per cent of the total number during the fifteen-year period, but accounted for only 3.2 per cent of total corporate net income and paid only 9/10 of one per cent of the Federal income taxes.

While these percentages are computed from the total number of returns filed exclusive of inactive corporations, such total undoubtedly includes many corporations whose operations are only nominal and some which are in the process of liquidation. This tends to exaggerate somewhat the proportion of corporations that have little or no income.

The next group, having incomes from $5,000 to $100,000, represented 15 per cent of the total in numbers, produced 18 per cent of the net income and paid 16 per cent of the taxes.

The three highest income groups, with corporate incomes of $100,000 and upwards, together numbered only about 9,000, or 2 per cent

of the total, yet they produced 78 per cent of all corporate net income and paid 83 per cent of the income taxes.

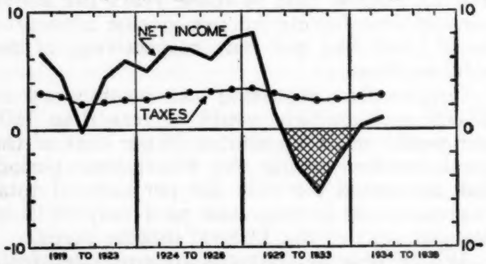
It is somewhat surprising to find, therefore, that 98 per cent of all corporations in this country produced only 22 per cent of the income and paid only 17 per cent of the taxes. As corporate income taxes have provided roughly one-fourth of total Federal Government revenues since the war, the contribution by 98 per cent of the corporations toward these revenues was but 4 per cent.

If, in revising the tax laws, all corporations earning even as high as $100,000 should be fully exempted from the surtax on undistributed income, the number affected might be about one-half of all corporations. Such action, however, while providing desirable relief to small, growing concerns, would give relatively little assistance toward employment and plant expenditures by the 2 per cent group of leading corporations which produce 78 per cent of the income and pay 83 per cent of the taxes. If, as has also been proposed, the resulting loss of Treasury revenue from this action should be offset by further raising the normal corporate income tax rates, thus shifting the burden to the larger corporations, the net effect on general business might actually be unfavorable.

Nor, obviously, would such tax exemption give much help to the large portion of corporations which currently have no net income and therefore pay no income taxes.

Total Taxes vs. Net Income

The trend of total direct corporation taxes paid and net income after taxes is shown in the accompanying chart, while the figures are



Taxes Paid and Net Income After Taxes of All Active Corporations in the United States.
(In Billions of Dollars)

given in the following consolidated summary for all corporations, with which readers of this Letter are familiar but which will bear frequent repetition.

It will be observed that, for the corporate system as a whole, the aggregate of taxes paid from 1919 to 1935 amounted to nine-tenths of the net profits (minus deficits) after taxes, that remained available for reinvestment or for dividends on the capital supplied by common and preferred shareholders.

All Active Corporations in the United States
(In Millions of Dollars)

Year	Gross Revenue	Taxes Paid	Net Inc. aft. Tax§	Net Inc. to Gross	Net Worth	Net Inc. to Net Worth
1919....	$100,473	$3,107	$6,419	6.38%	$ *	* %
1920....	118,956	2,823	4,469	3.75	*	*
1921....	91,947	2,175	–55	–0.06	*	*
1922....	101,315	2,302	4,380	4.32	*	*
1923....	119,020	2,572	5,827	4.89	*	*
1924....	119,747	2,552	4,998	4.17	*	*
1925....	136,711	2,900†	6,971	5.09	110,290	6.32
1926....	142,629	3,108	6,774	4.74	113,957	5.94
1927....	144,899	3,145	5,880	4.06	119,260	4.93
1928....	157,848	3,387	7,636	4.83	132,403	5.76
1929....	161,158	3,415	8,084	5.01	142,887	5.65
1930....	138,848	3,009	1,375	0.99	160,369	0.86
1931....	108,057	2,630	–3,145	–2.91	161,082	–1.95
1932....	81,638	2,373	–5,375	–6.58	143,263	–3.75
1933....	84,234	2,547	–2,378	–2.82	133,569	–1.78
1934....	101,495	2,758	162	0.16	127,578	0.13
1935-P	103,717	2,900†	958	0.92	141,585	0.68

Source: Compiled from annual Statistics of Income, Treasury Department. P- Preliminary. * Comparable data not reported. – Deficit. † Partly estimated. § Includes interest received on tax-exempt obligations, but excludes intercorporate dividends received.

In the six years 1930-1935 the corporate system, taken on a consolidated basis, had no net income after taxes, but a cumulative deficit of $8,403,000,000 instead. Yet during this period, the corporations paid taxes aggregating $16,217,000,000. The table and chart show the relative inflexibility of corporate taxes, many of which are based upon property valuation, capital stock or franchises, sales or gross income, etc., and must be paid regardless of whether or not there is any net income.

Even the total of taxes paid as given in the official statistics is an understatement, for the reason that the returns of many corporations do not show separately the payment of local and miscellaneous taxes, but include them in the "cost of goods" classification.

Direct taxes paid by corporations do not, of course, include many other taxes that bear on corporations indirectly. Among these might be mentioned sales and excise taxes for which the corporation acts merely as collecting and remitting agent; realty taxes that enter into the rents paid on leased property; income taxes upon the wages and salaries of officers and employes, upon the interest received by bondholders and the dividends received by shareholders; transfer taxes upon sales of securities, etc.; also countless taxes that enter into the cost of raw materials and services purchased.

Total Taxes vs. Dividends Paid

Because of the growing importance of the subject, a number of leading industrial corporations now give in their annual reports to shareholders the sum-total of taxes paid or accrued. The accompanying list compiled from the reports of some forty well-known companies in different industries will show the amounts taken by tax-gatherers last year, as compared with the dividends declared to shareholders (the latter including dividends

on preferred stock, back dividends and extras, as well as regular common dividends). In compiling the table, no effort has been made to hand-pick the companies, nor is it claimed that the experience of these companies is necessarily typical of all companies. The basis for selection is simply those leading companies for which aggregate tax figures are available.

Taxes and Dividends in 1936
(In Thousands of Dollars)

	Taxes Paid	Dividends Declared
Allis-Chalmers Mfg. Co.	$2.950	$ 2,417
American Can Company	6,838	15,256
American Metal Company, Ltd.	802	1,833
American Rolling Mill Company	2,515	5,749
Amer. Smelting & Refining Co.	6,000	13,166
American Tel. & Tel. System	116,800	168,081
Armstrong Cork Company	1,872	3,023
Atch., Topeka & Santa Fe Ry. Co.	14,103	11,063
Baltimore & Ohio Railroad Co.	10,496	None
Bethlehem Steel Corporation	12,033	10,391
Borg-Warner Corporation	3,850	4,724
Borden Company	5,205	7,035
Bklyn-Man. Transit Corporation	4,866	3,704
Chesapeake & Ohio Railroad Co.	13,318	29,096
Chi., Mil., St. P. & Pac. R.R. Co.	8,135	None
Chrysler Corporation	34,469	52,191
Con. Edison Co. of New York, Inc.	45,066	30,574
Deere & Company	3,901	3,703
Diamond Match Company	3,789	2,275
E. I. du Pont de Nemours & Co.	16,800	73,960
Marshall Field & Company	4,060	3,406
First National Stores, Inc.	1,435	3,040
Great Northern Railway Company	7,843	None
Interboro Rapid Transit Company	3,991	None
Jewel Tea Company, Inc.	851	1,772
S. H. Kress & Company	4,094	4,531
National Steel Corporation	5,400	6,750
New York Central Railroad Co.	30,812	None
New York, N. H. & H. R.R. Co.	5,569	None
Pennsylvania Railroad Company	34,714	13,168
Pittsburgh Coal Company	1,861	None
Pittsburgh Plate Glass Company	4,885	11,783
Radio Corporation of America	2,682	3,222
Sears, Roebuck & Company	12,442	30,485
Southern Pacific Company	13,935	None
Standard Brands, Inc.	7,105	13,777
Sun Oil Company	31,129	6,785
Swift & Company	7,730	5,898
Union Pacific Railroad Company	13,057	17,319
United States Rubber Company	12,063	None
United States Steel Corporation	52,895	50,439
Westinghouse Elec. & Mfg. Co.	8,920	14,637

NOTE: The table does not include oil and liquor companies, whose total tax payments are very large but are swelled by excise and sales taxes for which the companies act merely as collecting and remitting agents.

In the last analysis, all direct and indirect taxes bearing upon corporations must be shifted in one way or another to the people with whom the corporations deal. This means those to whom they sell their products or services, their employes and shareholders, those from whom they buy materials and services; —in other words, the general public. There should be no mistake in recognizing the fact that taxes on corporations enter into the cost of living for everybody.

Margin of Profit and Return on Capital

The figures in the summary showing the average annual rate of net profit to gross revenue deserve careful consideration. This rate has ranged from a high of 6.38 per cent in 1919 to a deficit of 6.58 per cent in 1932. For the entire period, taking the bad years with the good, the average was 2.17 per cent, while taking only the good years the average was 3.79 per cent.

This extremely narrow margin of net profit should not be confused with "gross profit," or "mark-up," or "value added." It represents the balance remaining to shareholders' capital after deducting the numerous items of operating, selling, administrative, overhead, research and development expense such as wages and salaries, materials and supplies purchased, advertising, rents and royalties, interest on money borrowed, freight, insurance, social security and other taxes; also deductions allowed by the Bureau of Internal Revenue for depreciation on plant and equipment, depletion of natural resources, inventory adjustments, losses on accounts and notes receivable, and losses upon real estate and investments.

With this final margin of corporate profit so narrow, it is apparent that any sharp raising of costs—whether for labor, materials, taxes, transportation or other items—must be guarded against. Such increases usually cannot be passed on to consumers in their entirety without checking consumption, but cut into profits or wipe them out entirely, thus removing the incentive to investment and expansion.

Statistics of corporate capital are available since 1925, and the average rate of consolidated net profits to net worth (preferred and common stock, plus surplus, minus deficits) ranged from 6.32 per cent in that year to a deficit of 3.75 per cent in 1932. For the eleven-year period, the average rate of return was 2.07 per cent, while for the eight profitable years the rate averaged 3.78 per cent.

In Conclusion

The strong sentiment in Congress for the repeal or modification of the tax on undistributed income promises a step in the right direction toward attacking the tax problem. In addition to the relief granted directly, the action will have a heartening effect as indicating the willingness of governments generally to adjust tax legislation as may be found necessary from time to time to enable business to carry the burden of supporting the various governments.

Undoubtedly, there is need for a comprehensive study of the entire national tax structure—at present consisting of an unscientific, almost hopeless, hodge-podge of multitudinous Federal, State and local taxes—to be followed by a complete overhauling and simplification of the structure that will remove the double and multiple overlapping and other patent inequalities, and also will reduce the number of tax laws, regulations and forms and afford relief from the excessive time, trouble and expense now involved in keeping records and preparing returns.

End RA

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